COUNCILMEMBER DONNA FRYE
City of San Diego
Sixth District

MEMORANDUM

08-35

DATE: **October 16, 2008**

TO: **David Wescoe, Administrator/CEO, SDCERS**

FROM: **Councilmember Donna Frye** Donna Frye

SUBJECT: **SDCERS Investments Strategies and Potential Losses**

I understand the San Diego City Employees Retirement System (SDCERS) has most, if not all, their securities, in a depository relationship with State Street Bank under a program where, for an annual fee (I believe approximately $1 million), SDCERS allows State Street Bank to 'lend' these securities owned by SDCERS to their other State Street Bank clients, or others, for financial activities unrelated to SDCERS.

According to an October 11, 2008, *The Wall Street Journal* article, State Street has now set restrictions and limitations on the recovery of these very same securities-lent assets (see attached article).

In the recent AIG federal government 'bailout,' the 'collateral' received from AIG's 'lending' of securities assets was subsequently re-invested in sub-prime, alpha-A and similar aggressive fixed rate assets. This was the cause of the Fed's most recent $37 billion additional 'bailout' funding.

I would like your confirmation that SDCERS securities-lent assets were not invested in any such aggressive mortgage assets or, if they were, what amounts were invested and a complete accounting of such holdings.

Please provide a written report on the SDCERS 'securities lending program,' and how this new State Street Bank policy will effect SDCERS assets and the City's pension system.

Of course, if any of these assets have been moved to any other depository, I would like your report to cover that depository as well.

In addition, what are the most recent mark-to-market losses, if any, in the SDCERS portfolio, particularly in the fixed income portfolio, and how are those losses reflected?

If SDCERS has a policy of taking only a portion, say 25%, of any loss in the year it occurred, I still want to know what is the total actual loss this year (as opposed to the smoothed loss) for such assets on a mark-to-market basis.

I would appreciate a response at your earliest convenience.

CC: Honorable City Councilmembers
Honorable Mayor Jerry Sanders
Michael Aguirre, City Attorney
Andrea Tevlin, Independent Budget Analyst
Stan Keller, Independent Monitor

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State Street Sets Restriction On Securities-Lending Funds

By CRAIG KARMIN

In the latest sign of the tightening squeeze on securities lending, the investment-management unit of State Street Corp. is restricting the ability of investors to withdraw money from such loan funds.

State Street Global Advisors told clients in a letter this week that they wouldn't be allowed to pull out money all at once from the firm's securities-lending funds. State Street offers at least four of those funds, which loan the securities of investors and then manage cash collateral received in exchange for the securities. The funds invest in various short-term instruments.

Clients who want to cash out of the securities-lending funds still can do so, but a portion of their money now will be parked in a separate investment pool run by State Street.

"Our securities-lending program remains strong," a spokeswoman for the Boston company said. "We have not experienced any losses, and there are no restrictions on normal course transactions within the lending funds."

Northern Trust Corp. and Bank of New York Mellon Corp. also have imposed restrictions on securities lending funds.

The restrictions underscore the continuing scramble by firms with securities-lending programs to head off any potential wave of redemptions being fueled by the frozen credit markets. Securities-lending programs are widely used by pension funds, endowments, index-fund managers and other large investors as a way of squeezing extra income out of a large stock or bond portfolio. Short sellers are among the biggest borrowers of shares.

But roiled markets have turned what had long been reliable gains from loaning shares into losses. As a result, firms that facilitate securities lending "are putting people on notice that they want to discourage any run on the fund," said Jim Meynard, executive director for the Georgia Firefighters Pension Fund, which is a client of State Street's securities-lending program.

Some pension funds are taking steps on their own to defuse the risks associated with securities lending. Bill Atwood, executive director at the Illinois State Board of Investment, which has about $1.6 billion in State Street's securities-lending program, is shifting those assets into a more conservative State Street collateral fund that invests in government securities or overnight corporate paper.

Bank of New York Mellon has said it is taking an after-tax charge of $425 million in the third quarter to pay back clients for losses in several funds. The New York bank says clients are unable to withdraw fully from these accounts but declined to elaborate.

Northern Trust, of Chicago, is posting an after-tax charge of $94 million in the third quarter to pay back investors who lost money in its securities-lending program.

Write to Craig Karmin at craig.karmin@wsj.com